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Central Intelligence Agency



Washington, D.C. 20505

## DIRECTORATE OF INTELLIGENCE

International Financial Situation Report #49  
13 February 1986

Summary

Falling oil prices and past spending excesses have plunged Mexico into a major financial crisis. Growing pressures from labor unions, leftists, and members of de la Madrid's cabinet are increasing the possibility that Mexico will pursue a more radical solution to its debt problems. In anticipation of such action, some banks are adding to their loan loss reserves and a few have reportedly cut interbank lines to Mexican banks.

Meanwhile, a Cartagena Group meeting is scheduled for 27-28 February in Punta del Este, Uruguay. In other developments:

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- o Brazil reached an agreement with its bank advisory committee to reschedule \$6 billion in medium-term debt that was due in 1985 and roll over an additional \$8 billion due this year.
- o Argentine President Alfonsin has pledged to sell six state-owned companies to the private sector. Polls show that most Argentines want to trim the public sector, but organized labor and the Peronists bitterly oppose it.
- o The IMF told Peru that its arrearages must be cleared up by mid-April or Peru will be declared ineligible for Fund resources. Garcia may hope that coming to terms with the World Bank will serve as an alternative to the Fund and help regain the confidence of other international lenders.
- o Concern about the Philippines is running high in international financial circles and neither Marcos nor Aquino appear to inspire banker confidence.
- o South African officials, commercial bank creditors, and debt mediator Leutwiler are to resume negotiations in London next week. Leutwiler likely will propose a compromise rescheduling agreement involving a 1 year extension of the current debt moratorium.

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NOTE: REPORT #50 WILL BE PUBLISHED ON 20 MARCH 1986.

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This situation report was prepared by analysts of the Intelligence Directorate. Comments are welcome and may be addressed to the Situation Report Coordinator

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## UPCOMING IMPORTANT DATES

<u>Date</u>	<u>Event/Country</u>	<u>Comment</u>
20 February	Commercial Debt Rescheduling Negotiations-South Africa (London)	South African officials, creditor banks, and debt mediator to discuss rescheduling \$14 billion in currently frozen debts. <span style="border: 1px solid black; display: inline-block; width: 100px; height: 1.2em; vertical-align: middle;"></span> 25X1
27-28 February	Cartagena Group Ministerial Meeting (Punta del Este)	Tentatively scheduled meeting of the Cartagena Group foreign and economic ministers. <span style="border: 1px solid black; display: inline-block; width: 100px; height: 1.2em; vertical-align: middle;"></span> 25X1
3 March	Paris Club-Guinea	Tentatively scheduled meeting to discuss rescheduling of debt owed to official bilateral creditors. <span style="border: 1px solid black; display: inline-block; width: 100px; height: 1.2em; vertical-align: middle;"></span> 25X1
3-6 March	Group of 24 Meeting (Buenos Aires)	<span style="border: 1px solid black; display: inline-block; width: 350px; height: 40px; vertical-align: middle;"></span> 25X1
4 March	Paris Club-Zambia	Tentatively scheduled meeting to discuss rescheduling of debt owed to official bilateral creditors. <span style="border: 1px solid black; display: inline-block; width: 100px; height: 1.2em; vertical-align: middle;"></span> 25X1
6-7 March	Paris Club-Poland	Tentatively scheduled meeting to discuss rescheduling of debt owed to official bilateral creditors. <span style="border: 1px solid black; display: inline-block; width: 100px; height: 1.2em; vertical-align: middle;"></span> 25X1

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KEY ISSUES

Mexico Considers New Debt Strategy

Falling oil prices and past spending excesses have plunged Mexico into a major financial crisis. Growing pressure from labor unions, leftists, and members of de la Madrid's cabinet is increasing the possibility that Mexico will pursue a more radical solution to its debt problems.

- o Last week 50,000 marched in Mexico City to demand a debt moratorium be declared, according to press reports.
- o Labor kingpin Fidel Velazquez has reversed his earlier position that debt payments should be met.
- o Within the Cabinet, which has been meeting frequently in emergency sessions, only Finance Minister Silva-Herzog believes Mexico should seek more foreign credits, cut back on public spending, and reduce imports, according to Embassy reporting. [REDACTED]

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[REDACTED]

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[REDACTED]

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According to press reporting, a Cartagena Group meeting is scheduled for 27-28 February in Punta del Este, Uruguay. We believe Mexico will present its plan for curtailing interest payments for discussion. The Group considered a variety of actions at their last ministerial meeting in December and they may now be ready to adopt specific measures to ease the region's liquidity crisis. [REDACTED]

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De la Madrid lacks the political will to ask Mexicans to make more sacrifices. Unless substantial new money or concessions are forthcoming, he is likely to tell creditors that Mexico cannot honor its obligations. [REDACTED]

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Foreign Reaction to Baker Plan

Commercial bank and creditor government reaction to the US initiative on debt falls short of unanimous support. [REDACTED]

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DEVELOPMENTS IN MAJOR COUNTRIES

Brazil

Brazil reached a debt restructuring agreement with its bank advisory committee last month to reschedule \$6 billion in medium-term debt that was due in 1985, roll over an additional \$8 billion due this year, and maintain \$16 billion of short-term credits until 1987, according to press reporting. [REDACTED]

interest rate spreads, relending terms, and resolution of the issue of repaying the foreign obligations of three failed Brazilian banks remain to be worked out. In commenting on the agreement, Finance Minister Funaro asserted that Brazil will never again need a formal IMF program. To allay creditor fears that Brasilia may be adopting a confrontational position with the IMF, however, Funaro has stressed to the press that his relationship with the Fund, and with Managing Director de Larosiere in particular, has been extremely cooperative. According to the US Embassy, Funaro divulged to the US Ambassador in early February a new proposal for a multiyear debt restructuring which he hopes to discuss officially with the US Government. Although details are lacking, Funaro reportedly wants to arrange for a rescheduling of debt over 15 years without an IMF standby arrangement. Funaro envisions the IMF's role as being restricted solely to comment on Brazil's economic program which would contain only external targets and would be developed without IMF involvement. [REDACTED]

In our judgment, Brazil will achieve its third successive trade surplus in excess of \$12 billion this year despite the detrimental impact of the widely-publicized drought in southern Brazil. US Embassy [REDACTED] sources have pointed to potential drought-related foreign exchange losses of about \$2 billion resulting from reduced exports of soybeans and sharply increased imports of grain. We believe, nevertheless, that the following advantageous price developments will offset these losses:

- o Sharp rises in coffee prices will likely lead to an increase of \$800 million to \$1 billion in coffee export earnings.
- o Plummeting oil prices will likely permit roughly a \$1 billion reduction in Brazil's oil import bill. [REDACTED]

### Argentina

Last week President Alfonsin announced a bold follow-up to the economic reform program begun in June. He proposed selling six state-owned companies to the private sector, including Argentina's largest steel plant and two leading petrochemical concerns. Buenos Aires also announced it would create export programs based on tax credits for industrial exports, and implement a land tax which would allow it to reduce duties on agricultural exports. This provides an encouraging sequel to recent setbacks, including selective wage increases and a lukewarm response by foreign oil companies to the government's exploratory tract bidding program. Polls show that most Argentines want to trim the public sector and they, along with foreign creditors, probably will applaud Alfonsin's program, while organized labor and the Peronists will bitterly oppose it. [ ]

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The reforms, however, may not resolve the stalled negotiations between Buenos Aires and the IMF which have blocked disbursements of \$600 million from commercial banks and \$262 million from the IMF originally slated for release late last year. In addition, although Alfonsin characterized his announcement as the first phase of the second stage of the austral plan he failed to specify any measures to lift the wage and price freezes. Nevertheless, the implementation of structural changes such as the ones just announced could lay the groundwork for non-inflationary growth, an eventual revival of business investment, and thus enhance Argentina's capability to service its foreign debt. [ ]

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## REGIONAL SITUATIONS

### Latin America

In Latin America, Peru has until 16 April to clear its arrears with the IMF or else be declared ineligible, and Panama continues to have difficulties meeting the World Bank's requirements for a second SAI. [ ]

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### Peru

Finance Minister Alva Castro and Foreign Minister Wagner visited Canada and the US earlier this week for debt talks with lenders and government officials. President Garcia recently told official US visitors that he aims to obtain easier rescheduling conditions with lower interest rates. In mid-January, Garcia authorized a symbolic payment on arrears to the IMF, but has paid commercial banks only \$1 million in operating expenses. [ ]

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The popularity of Garcia's past harsh statements against the IMF still limits his maneuvering room, however, and he probably cannot seek a formal IMF standby without losing face. In fact, this week in Lima he vehemently rejected the decision by the IMF Executive Board requiring Peru to eliminate its arrears by 16 April or expect that the Board will declare Peru ineligible. Garcia may hope that coming to terms with the World Bank will serve as an alternative to the Fund and help regain the confidence of other international lenders. However, Garcia probably will pay arrearages only to those lenders who are willing to provide additional assistance to Peru. If creditors threaten to take punitive action, however, the volatile and nationalistic Garcia could repudiate the debt or take new moves against US interests in Peru. [ ]

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[REDACTED]

Ecuador

President Febres-Cordero fears that the economic recession and balance of payments disequilibrium resulting from falling oil prices endanger his experiment with free market economics and threaten to undo Ecuador's recently signed accords with international lenders, according to Embassy reporting. Foreign Minister Teran voiced concern that a recession would strengthen domestic critics of the President's close relations with Washington and the IMF, and could result in a sweeping defeat for the President's coalition in June's congressional elections. [REDACTED]

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According to the US Embassy, real GDP growth this year is likely to fall short of the government's 3.7 percent target—a target based on earlier estimates of oil exports at \$23 per barrel. Continuation of oil at the current \$19 per barrel could result in slower economic growth this year, whereas oil at \$15 could result in even lower GDP growth.

[REDACTED]

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If oil holds at \$19 per barrel, however, [REDACTED] the balance of payments gap would be more manageable because the administration's flexible exchange rate policy and soaring coffee prices are likely to boost nonoil export revenues by nearly enough to compensate for the shortfall in oil revenues. In this less pessimistic case, merchandise exports would total about \$2.6 billion—still sufficient to cover this year's import needs, plus 1986's debt service payments of \$750-800 million [REDACTED]

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[REDACTED] Nevertheless, oil prices at current levels or below are likely to exacerbate Febres-Cordero's problems with the political opposition and student radicals—just at the time that he was hoping for some relief in order to focus on the growing domestic terrorist threat. [REDACTED]

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Panama

Economic reforms announced by President Delvalle last month do not yet go far enough in meeting World Bank requirements for a second structural adjustment loan (SAL), according to US Embassy reporting. The Bank reportedly is satisfied with Devalle's proposed labor and agricultural reforms, but Panama's industrial incentives law—which maintains protectionist policies and subsidies for manufacturing—remains a contentious issue. Financial pressures on Delvalle are mounting, however, and may speed resolution of the SAL. Lower than expected external financing last year and soft revenue collections reportedly are straining the government's liquidity position, and may have pushed Panama out of compliance with its end-December 1985 IMF target for government domestic borrowing. [REDACTED]

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Eastern Europe

In Eastern Europe, Paris Club creditors proposed a formula to share Polish debt relief proportionately between banks and governments. [REDACTED]

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Poland

At its January meeting, Paris Club creditors agreed that the \$2.8 billion in debt relief which they estimate Warsaw needs should be shared by governments and banks, based on the proportion of debt held by each in 1981—roughly a 60/40 percent split. Under the Paris Club formula, governments would postpone \$1.7 billion of their \$3 billion worth of Polish payments due in 1986, while banks would reschedule \$1.1 billion

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[redacted]  
out of \$1.7 billion owed. [redacted]

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[redacted] Even with the reschedulings, however, we estimate that the payments due will still exceed Poland's payment capacity of \$2 billion. The press reported that Poland, at a January meeting, asked banks to reschedule up to \$800 million in principal payments due in 1986. Bankers have not yet responded to this request. [redacted]

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### Asia

In Asia, creditors remain concerned by political tensions in the Philippines. [redacted]

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### Philippines

Concern about the Philippines is running high in the international financial community and neither Marcos nor Aquino appear to inspire banker confidence.

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[redacted] Manila's ability to comply with its March performance criteria is in doubt. While Prime Minister Virata has stated he would like to begin discussions on rescheduling the Philippines' debt falling due in 1987-88 in mid-April, creditors believe that Virata must realize that the country is likely to be out of compliance by then, making such negotiations unlikely. [redacted]

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[redacted]

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### Africa/Middle East

South Africa's debt negotiations are scheduled to resume next week in London, and Sudan was declared ineligible for use of IMF resources. [redacted]

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### South Africa

South African officials, commercial bank creditors, and debt mediator Fritz Leutwiler are to resume negotiations next week in London to reschedule \$14 billion in currently frozen debts. Leutwiler likely will propose a compromise involving a 1 year extension of the current debt moratorium before repayments begin. [redacted]

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[REDACTED]

Sudan

The IMF last week declared Sudan ineligible for Fund resources following more than a year of unsuccessful attempts by Khartoum to negotiate an acceptable economic reform package and a resolution of arrearages to the Fund, which currently total about \$227 million. Last minute attempts by the regime to forestall the IMF action, including a \$10 million partial payment against the arrears, were insufficient to alter the IMF's decision. The Sudanese cabinet termed the declaration "unfair," according to the US Embassy. [REDACTED]

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[REDACTED] Meanwhile, Sudan paid off \$1.9 million in Foreign Military Sales loan arrearages last month, but has again fallen under Brooke Amendment sanctions pending clearance of an additional \$5.4 million in FMS payments which became one year overdue this week. [REDACTED]

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**FINANCIAL BRIEFS****International**

- o **Cartagena Group** to meet in Uruguay later this month...meeting requested by Mexican President de la Madrid and Venezuelan President Lusinchi...group to discuss curtailing interest payments to foreign creditors. [ ] 25X1
- o OAU, UN preparations beginning for May **UN Special Session** on African economic situation...OAU steering committee last month recommended against including debt as specific agenda item...UN Preparatory Commission to resume work on agenda late this month. [ ] 25X1

**Americas**

- o **Bolivia's** understanding with the IMF on a possible standby agreement in jeopardy...Congress vetoed President's proposed revenue raising program but has not proposed a feasible alternative...also failed to approve the federal budget and to produce an audited Central Bank balance sheet, prerequisites for IMF approval. [ ] 25X1
- o **Costa Rican** SAL review in trouble...problems must be resolved before \$40 million second tranche is disbursed...tariff reform performance and public sector employment increases found unacceptable. [ ] 25X1
- o **Cuba** has informed its commercial bank creditors it will request a rescheduling of a portion of its foreign debt in 1986...rescheduled about 25 percent of debt in 1985...claims figure will be lower this year. [ ] 25X1
- o **Dominican Republic** adjustment programs on track...met 31 December IMF performance targets...reached agreement with commercial banks and moving toward Paris Club accord...next major step is congressional approval of agreements. [ ] 25X1
- o IMF representative believes **Uruguay** will pass performance review next week...would clear way for third \$16 million tranche by April... continued compliance with program could facilitate commercial bank rescheduling accord for about \$1.9 billion in two months. [ ] 25X1

**Europe/USSR**

- o **Hungary's** 1985 current account deficit was \$450 million compared to a surplus of \$270 million in 1984...decline due mainly to fall of agricultural prices and decreased hard currency surplus with CEMA... \$1.6 billion in borrowings covered deficit and increased foreign exchange reserves. [ ] 25X1
- o **Yugoslavia** agreed with the IMF to move toward real interest rates...had been out of compliance with its standby since refusing to increase interest rates as required on 1 January...will raise rates retroactively to 1 February for at least the next two months. [ ] 25X1

- o **Yugoslavia's** balance of payment accounts worsened last year...convertible current account surplus fell from \$865 million surplus in 1984 to \$344 million in 1985...hard currency trade deficit grew by 50 percent. 25X1

### Africa/Middle East

- o IMF staffer puts **Egypt's** foreign debt at \$37 billion, higher than most previous estimates...\$5.5 billion in short-term debt largely owed by four public sector banks...debt service in 1986 expected to be \$3.7 billion. 25X1
- o **Ivory Coast** likely to accept bank advisory committee counterproposal for multiyear rescheduling of \$1.1 billion due 1986-1989... 25X1  
World Bank meanwhile to invite Abidjan to negotiate third SAL for \$250 million. 25X1
- o IMF last month declared **Liberia** ineligible to use Fund resources pending clearance of some \$50 million in arrears to Fund...most government revenues mortgaged through July by President Doe's campaign effort to pay overdue salaries. 25X1

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- o **Morocco** made its overdue payment of \$78 million to commercial creditors on 30 January...bankers likely to accept payment as alternative would mean renegotiation of 1983-84 rescheduling agreement...Rabat says money came from belt tightening, not foreign assistance. 25X1
- o **Nigeria** has yet to implement devaluation pledges contained in the 1986 budget...failure to cut oil prices in line with market trends led to a 25% drop in oil production last month 25X1
- o **Tanzanian** talks with IMF for standby arrangement lapsed last week...conflicts over devaluation, parastatal mismanagement, price subsidies...President Mwinyi 25X1  
has no 25X1  
tangible plans for economic recovery. 25X1
- o **Zambia** to receive new two-year IMF standby arrangement this month...Lusaka cleared all arrears to Fund, met key budget targets...Paris Club meeting tentatively scheduled for March. 25X1

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 61 Ch/OGI/EC  
 62-63 Ch/OGI/EC/FI  
 64 [redacted] OGI/CO  
 65 CPAS/ISS/SA/DA  
 66 Ch/OGI/Pub [redacted]  
 67-69 OGI/Pub # 67 Destroyed 2/24/86 S. Maxwell  
 70-75 CPAS/IMC/CB

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